

Real Estate Transfer Tax

1. What it is:

Real estate transfer taxes (“RETTs”) are essentially sales taxes on the sale of real property. Typically states and localities charge the buyer and/or seller of real property (i) a tax based on a percentage of sale value of the property, (ii) a flat deed registration tax, or (iii) a combination of both. In some states, the RETT is called a documentary stamp tax. Fla. State. §§ 201 et. seq. (2003). Generally, certain categories of transactions are exempt from the application of RETTs: transfers between spouses or between parent and children, transfers to government entities, transfer to business owned 100% by guarantor, for example. Nev. Rev. Code § 375.090 (2003).

The proposal before this commission is the application of a real estate transfer tax based on a percentage of sales value with an exemption for the first \$100,000 of value.

Arizona currently has no RETT and a mere \$9 filing fee for every deed or contract recorded with the county recorder. See, www.recorder.maricopa.gov/fees.htm.

2. How it would be administered:

Although administered in a variety of ways, a RETT generally is collected at the county or local level as a requirement to recording a new deed and at the state level for sales that do not involve the recording of a new deed.

Transfers of residential real estate generally involve the recording of a deed and are therefore relatively easy to administer. In those cases, the RETT is administered and collected at the county or local level. A purchaser of real estate in Aspen, Colorado, for instance, is required to obtain a “paid” or “exempt” stamp on the real property deed recorded with the county. City of Aspen Municipal Code § 2348 (2003). The purchaser obtains the stamp by paying a fee to the City of Aspen, based on the affidavit of valuation. *Ibid.* If an appropriate stamp is not obtained, the purchaser’s property is subject to a tax lien, which will make it difficult for the purchaser to obtain title insurance upon the future sale of the property. *Ibid.*

Transfers of commercial real estate often do not involve the recording of a new deed. Rather, transfers of real estate often occur at the company ownership level, upon a merger of companies, the sale of stock or the transfer of other legal units of ownership interest. To capture these types of transactions, some states and municipalities include within the statutory definition of a “sale” for RETT purposes “[transfer of a] controlling interest in any entity with an interest in real property located in this state.” Wash. Rev. Code § 82.45.010(2) (2003). The state of Washington requires a seller to pay a RETT on the sale of property, but transfers the responsibility to the buyer post-closing upon lack of payment, thus allowing the state to file a tax lien on the real property. Wash. Rev. Code § 82.45.070 (2003). The state’s department of revenue directly collects the RETT on the

sale of real property in which no new deed is recorded. Wash. Rev. Code § 82.45.090 (2003).

As in Washington, in Arizona buyers record the transfer of real property by recording deeds at the county level along with an affidavit of value. Because of the similarities in the administration of recording deeds and the type of RETT being considered, the most efficient manner of administering a RETT in Arizona appears to be to follow Washington's model of requiring the payment of the tax or the claim of exemption from the tax at the time the purchaser files his affidavit of property value with the county recorder (or identifies the exemption which removes the requirement to file an affidavit of value) and collecting the RETT on transfers that are not recorded through a new deed directly through the state department of revenue.

3. Impact on Existing Revenue Systems:

Because the funds run directly to the state and the administration of a real estate transfer tax occurs at the county level, we expect the localities' revenues will not be affected by the application of a real estate transfer tax.

We expect the counties' revenues will not be affected by the application of a real estate transfer tax. However, a large portion of the administration of the tax probably will occur at the county level, creating a modest administrative cost at the county level. Some states, including Washington, allocate a share of the RETT collected from each county back to the county to cover administrative expenses and share the benefit of the rising value of the local real estate. Wash. Rev. Code § 82.45.190 (2003). Some states also allow counties and localities to apply an individual RETT in addition to the state RETT.

We do not expect a real estate transfer tax to have a secondary affect on other, current revenue sources.

4. Cost:

The cost of administering a real estate transfer tax would be modest because the mechanisms for collecting and processing a real estate transfer tax are already in place. For instance, the Maricopa County recorder already examines all deeds filed for an accompanying affidavit of value or appropriate claim of exemption. The collection of the RETT, based on the affidavit of value, and the remittance of the RETT to the State would be the additional burden put upon the counties. Washington State allows the counties to keep 1% of the RETT to pay for the administrative costs. Wash. Rev. Code § 82.45.190 (2003).

In addition, the cost of monitoring the program as to the sales of real estate that result in a recordation of a new deed would be absorbed in great part by private industry through title agencies who would require all real estate transfer taxes to be paid prior to issuing title insurance.

The cost of monitoring the program as to sales of real estate that are not recorded as a new deed is harder to estimate, but is not expected to be high. The latter type of sales are

not necessarily recorded in any public forum. Rather, the states that administer a RETT generally use the legal and business community as a proxy for enforcement and independently monitor news of corporate mergers and acquisitions through newspapers, magazines and other publications. This monitoring cost probably would fall upon the department of revenue or other agency responsible for collection of the RETT in the absence of deed recordation.

We believe the compliance cost to business and individual tax payers would be minimal because each purchaser of real estate in the state of Arizona already files an affidavit of value as part of the recordation of a deed. The real estate transfer tax amount would be a calculation based on that disclosed value. Although the tax is imposed on the purchaser, most purchasers probably will transfer the cost to the seller and require the tax to be paid out of the sale proceeds. The escrow agent probably will pay the real estate transfer tax after funding and prior to the recording of the deed.

In the situation where no deed is recorded, an additional cost associated with obtaining an estimate of the fair market value of the real estate is probable. This, too, is not likely to be prohibitively difficult, although it does provide some room for manipulation.

5. Policy Considerations:

A. Equity

Applied equally across all real estate transactions, a real estate transfer tax ranks high in horizontal equity. However, the tax is generally not progressive in the way that it is applied in most states. The flat percentage or flat fee tax applies equally to the small, residential purchase of \$100,000 and to the commercial property purchase of \$4.0 million. However, the tax could be made highly progressive in Arizona by exempting the first \$100,000 or so of the sales price. (An alternative that would allow tax collections to keep pace with inflation would be to set the exemption equal to about two-thirds of the statewide median sales price.) For example, if a tax rate of 1 percent were applied only to the amount of the sales price in excess of \$100,000, the tax would be zero on properties up to \$100,000, \$500 on the typical \$150,000 residence (0.33 percent effective rate), and \$4,000 on a \$500,000 property (0.8 percent rate). Applying an increasing percentage rate with increasing value of the property would make the tax even more progressive, but appears to be rarely done because of the disproportionate burden this places on commercial real estate transactions.

B. Economic Vitality

Arizona is one of just 14 states not to levy a real estate transfer tax. National Conference of State Legislatures Fiscal Affairs Program, [http://www.realtor.org/smartgrowth2.nsf/0d520d8ef587ba7486256aa40057e481/cd36d728c05dd34885256b5d005e243c/\\$FILE/transfertaxes.pdf](http://www.realtor.org/smartgrowth2.nsf/0d520d8ef587ba7486256aa40057e481/cd36d728c05dd34885256b5d005e243c/$FILE/transfertaxes.pdf). Most of the 37 states using this tax apply a flat rate, though a few apply a higher rate for higher value transactions. The rate varies widely by state, from 0.01 percent up to

2 percent, with the median of the states applying the tax being 0.4 percent (a tax of \$400 for a property valued at \$100,000, \$600 for the typical \$150,000 residential property, and \$2,000 for a \$500,000 property). Ibid. Among the 10 comparison states, New Mexico, Oregon, Texas and Utah also do not use this tax, with the rates in the other states ranging from 0.01 percent in Colorado to 1.28 percent in Washington. Because Arizona is in the minority of states that do not use a real estate property tax and because the rate proposed is at the national median level, the application of a real estate transfer tax is not expected to be uncompetitive.

To hold down the business tax burden, a greater exemption than \$100,000 and/or a lower tax rate could be considered for nonresidential transactions. It does not, however, appear that our competitor states have applied this type of benefit for nonresidential transactions.

C. Volatility

The level of revenue raised by the RETT is moderately volatile. In Washington State, for instance, the annual change in RETT revenue collection between fiscal years 1992 to 2001 ranged as high as 26% and as low as -9%. Washington State Department of Revenue, Washington State Tax Reference Manual, p. 182 (2002). In Arizona, collections over this decade likely would have been less variable than in Washington. For example, a simplistic look at the residential market in Maricopa County is shown below, using data from the Arizona Real Estate Center at Arizona State University. The median price multiplied by the number of transactions is used as a proxy for the total value of transactions. The percent change in total value is used as a proxy for the change in RETT collections.

	Number of Transactions	Median Price	Estimated Total Value in Millions	Percent Change in Total Value
1992	44,590	\$86,500	\$3,857	
1993	60,160	88,100	5,300	37.4%
1994	67,920	94,000	6,384	20.5
1995	66,950	99,600	6,668	4.4
1996	81,025	106,675	8,643	29.6
1997	82,110	111,220	9,132	5.7
1998	94,150	117,000	11,016	20.6
1999	98,725	124,900	12,331	11.9
2000	97,620	131,000	12,788	3.7
2001	103,130	137,500	14,180	10.9
2002	106,535	144,500	15,394	8.6

Continuing to use the total value of real estate transactions as a proxy for RETT collections, we looked back 19 years beginning with 1983 (the first year of data

on real estate transactions) to test how volatile the RETT collections would have been compared to individual and corporate income tax, during at least two economic downturns: one in the late 1980s and the other in the late 1990s. Using income tax data from the Joint Legislative Budget Committee and adjusting the income tax collection amount for the tax law changes starting in 1989, we find that the RETT collection is more volatile than individual income tax collection, but less volatile than corporate income tax collection. The annual inflation-adjusted changes during the 1983 to 2002 period are summarized below.

	Individual Income Tax	Corporate Income Tax	Real Estate Transfer Tax (Estimated)
At least 25%	0	3	2
20 to 24.9	0	0	0
15 to 19.9	2	2	2
10 to 14.9	7	4	3
5 to 9.9	4	1	3
0 to 4.9	2	1	4
-0 to -4.9	3	2	2
-5 to -9.9	1	0	1
-10 to -14.9	0	2	0
-15 to -19.9	0	2	2
-20 to -24.9	0	0	0
At least -25	0	2	0

The amount of revenue generated from a real estate transfer tax will vary largely with the number of real estate transactions, though housing appreciation rates and the type of housing being built impacts home values and therefore the amount of tax collected. The economic cycle and demographic changes affect the housing market, with mortgage interest rates having a particularly large effect due to their strong impact on affordability. Mortgage rates are affected by various factors, including federal monetary policy, supply and demand, and inflation rates.

More interesting is that the RETT collections do not always rise or fall with the economic cycle. For instance, the RETT collections would likely have fallen with the economic downturns of the late 1980s, but would have likely continued to increase in the early 2000s, counter to the economic downturn of the early 2000s. The economic downturn of the late 1980s and early 1990s was centered particularly on the real estate market. Real estate values fell on an inflation-adjusted basis, largely due to overbuilding and excessive speculation earlier in the 1980s, and the number of real estate transactions dropped substantially due to the weak economy. Thus, real collections from a real estate transfer tax likely would have dropped for five consecutive years, with declines in two of those years being

substantial. In contrast, due to low mortgage interest rates and favorable demographics, the home market remained strong during the economic slump of the early 2000s. Collections from a RETT would have continued to grow on a real basis, though at a slower pace than in most years between 1992 and 1999. Income tax collections declined sharply in fiscal year 2002.

D. Simplicity

See answer to question 4.

6. Economic Impact:

We believe an estimation of the revenue raised by a RETT in Arizona should look back at the history of real estate transactions for an entire economic cycle. For the limited purposes of this report, we have looked at the recorded real estate transactions for Maricopa County for a 30-day period between the end of February to end of March and extrapolated the data over the state of Arizona based on 2000 census data. We did not have information regarding the real estate transactions that were not recorded by filing of a new deed. In the absence of better data, we are only able to estimate the relative amount that would be collected from the relative amounts other states collect between the nonrecorded deed transactions and the recorded deed transactions. This estimation assumes Arizona's nonrecorded to recorded real estate transaction relationship mirrors that of the comparison state.

Given these assumptions and extrapolations, we believe that if Arizona exempted the first \$100,000 of value on residential homes, applied a 0.25% tax rate to the portion of the sales price exceeding \$100,000 up to \$250,000 and a 1.00% tax rate applied to the portion of the sales price exceeding \$250,000, the annual RETT from the sale of residential homes would be approximately \$100 million.

If Arizona were to apply a RETT using the same formula on commercial transactions, we estimate the annual RETT revenue would be about \$65 million for recorded transactions and a few million more for non-recorded transactions.

The total annual revenue collected (residential and commercial combined) would be close to \$170 million

A. Residential Real Estate Transactions

Maricopa County

This analysis was conducted using the March 2003 file of real estate transactions in Maricopa County purchased by the Arizona Real Estate Center at ASU from a local company, Marketron. (The file consists of recordings made from late February through late March.) Only residential (use codes 01 – Single Family and 07 – Townhouse/Condominium) transactions were included; the file excludes transactions of less than \$25,000.

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The number of records was 11,001 — a higher figure than in most recent months. The median recorded sales price was \$148,750. The frequency distribution follows.

Recorded Sales Amount	Percentage of All Recordings
\$25,000 to \$49,999	1.3%
\$50,000 to \$74,999	3.7
\$75,000 to \$99,999	9.0
\$100,000 to \$124,999	17.1
\$125,000 to \$149,999	19.8
\$150,000 to \$174,999	13.7
\$175,000 to \$199,999	8.5
\$200,000 to \$249,999	10.8
\$250,000 to \$299,999	5.8
\$300,000 to \$499,999	7.4
\$500,000 or more	2.9

Tax collections were calculated under six possible sets of tax rates and exemptions:

- Plan A: 0.25% tax rate applied to the entire sales amount
- Plan B: 0.25% tax rate applied only to the portion of the sales price exceeding \$50,000
- Plan C: 0.25% tax rate applied only to the portion of the sales price exceeding \$100,000
- Plan D: 0.25% tax rate applied only to the portion of the sales price exceeding \$150,000
- Plan E: 1.00% tax rate applied only to the portion of the sales price exceeding \$100,000
- Plan F: 0.25% tax rate applied to the portion of the sales price exceeding \$100,000 up to \$250,000 and 1.00% tax rate applied to the portion of the sales price exceeding \$250,000

Plan	Taxes Collected
A	\$ 5.29 million
B	3.91
C	2.62
D	1.68
E	10.49
F	5.31

Except for Plan A, each plan is progressive, with plan F the most progressive. Note that tax collections are nearly identical under plans A and F. Effective tax rates were calculated under each plan, as follows.

Sales Price	Effective Tax Rate by Plan					
	A	B	C	D	E	F
\$50,000	0.250%	0.000%	0.000%	0.000%	0.000%	0.000%

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\$75,000	0.250	0.083	0.000	0.000	0.000	0.000
\$100,000	0.250	0.125	0.000	0.000	0.000	0.000
\$125,000	0.250	0.150	0.050	0.000	0.200	0.050
\$150,000	0.250	0.167	0.083	0.000	0.333	0.083
\$175,000	0.250	0.179	0.107	0.036	0.429	0.107
\$200,000	0.250	0.188	0.125	0.063	0.500	0.125
\$250,000	0.250	0.200	0.150	0.100	0.600	0.150
\$300,000	0.250	0.208	0.167	0.125	0.667	0.292
\$500,000	0.250	0.225	0.200	0.175	0.800	0.575
\$1 million	0.250	0.238	0.225	0.213	0.900	0.788
\$5 million	0.250	0.248	0.245	0.243	0.980	0.958
\$10 million	0.250	0.249	0.248	0.246	0.990	0.979

Arizona

A simplistic estimate of statewide revenues was estimated using 2000 census data. At that time, 59.1% of the state's owner-occupied housing units were in Maricopa County. The statewide median value was 6.1 percent less than the median in Maricopa County. Using these data and assuming that real estate activity elsewhere in the state is at the same pace as that in Maricopa County, estimated collections follow.

Plan	Taxes Collected
A	\$ 8.4 million
B	6.2
C	4.2
D	2.7
E	16.7
F	8.4

B. Commercial property

Maricopa County

This analysis also was conducted using the March 2003 file of real estate transactions in Maricopa County. Commercial transactions with use codes 03 through 06 and 09 through 89 were included; the file excludes transactions of less than \$25,000. (Note that vacant land and mobile homes were not included in either the commercial or residential analysis.) The number of commercial records was only 478. The median recorded sales price was \$230,000. The frequency distribution that follows shows more dispersion than that for residential transactions, with nearly 30 percent of the transactions for at least \$500,000.

Recorded Sales Amount	Percentage of All Recordings
\$25,000 to \$49,999	4.4%
\$50,000 to \$74,999	5.8
\$75,000 to \$99,999	4.9
\$100,000 to \$124,999	9.4

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\$125,000 to \$149,999	8.0
\$150,000 to \$174,999	5.7
\$175,000 to \$199,999	4.8
\$200,000 to \$249,999	10.6
\$250,000 to \$299,999	5.9
\$300,000 to \$499,999	10.9
\$500,000 or more	29.3

Tax collections were calculated under the same six possible sets of tax rates and exemptions.

Plan	Taxes Collected
A	\$ 1.18 million
B	1.12
C	1.06
D	1.02
E	4.25
F	3.92

Arizona

Maricopa County accounts for about 73 percent of the dollar value of economic activity in Arizona. Assuming that this ratio also holds for Maricopa's share of commercial real estate activity, estimated RETT collections for the state follow.

Estimated Taxes Collected in Arizona, March 2003			
Plan	Commercial	Residential	Total
A	\$ 1.6 million	\$ 8.4 million	\$10.4 million
B	1.5	6.2	7.7
C	1.4	4.2	5.6
D	1.4	2.7	4.1
E	5.8	16.7	22.5
F	5.4	8.4	13.8

Under plan F, annual collections would be about \$165 million, assuming March is a representative month. To estimate the amount of RETT the state would collect from real estate transactions that are not recorded by filing of a new deed, we looked to the state of Washington. The Washington Department of Revenue estimates that the amount of RETT it receives directly at the state level from transactions that do not involve the recording of a deed ranges from 1 to 3% of the total RETT collected per fiscal year. (Conversations with Department of Revenue Research Division on May 19, 2003). If we assume Arizona would have similar

collections, the RETT collected in our model year would rise by approximately \$2 million to \$5 million.

7. Other:

One particular strength of a real estate transfer tax is that the tax burden can be partially exported. Purchases by seasonal residents (an increasing share of whom are purchasing a residence rather than renting or living in a recreational vehicle or mobile home) would be taxed, as would transactions made by those moving from the state.

On the other hand, some have argued that the real estate transfer tax has a negative effect on homeowners' affordability. However, the median existing tax rate of 0.4 percent prices very few potential buyers out of the market and has little effect on the type of home purchased by those not priced out of the market. Exempting the first \$100,000 of the purchase price and applying a higher tax rate than 0.4 percent to the balance would be unlikely to restrict anyone from buying a home.

Overall, we believe instituting this tax in Arizona, including a local option or a shared revenue to counties and cities, represents an opportunity to broaden the overall tax base while lowering tax rates overall, while being consistent with the tax code of other states.

APPENDIX: Example of definition of “sale” (and what is exempt) under Washington Revised Code

Revised Code of Washington 82.45.010

"Sale" defined.

(1) As used in this chapter, the term "sale" shall have its ordinary meaning and shall include any conveyance, grant, assignment, quitclaim, or transfer of the ownership of or title to real property, including standing timber, or any estate or interest therein for a valuable consideration, and any contract for such conveyance, grant, assignment, quitclaim, or transfer, and any lease with an option to purchase real property, including standing timber, or any estate or interest therein or other contract under which possession of the property is given to the purchaser, or any other person at the purchaser's direction, and title to the property is retained by the vendor as security for the payment of the purchase price. The term also includes the grant, assignment, quitclaim, sale, or transfer of improvements constructed upon leased land.

(2) The term "sale" also includes the transfer or acquisition within any twelve-month period of a controlling interest in any entity with an interest in real property located in this state for a valuable consideration. For purposes of this subsection, all acquisitions of persons acting in concert shall be aggregated for purposes of determining whether a transfer or acquisition of a controlling interest has taken place. The department of revenue shall adopt standards by rule to determine when persons are acting in concert. In adopting a rule for this purpose, the department shall consider the following:

(a) Persons shall be treated as acting in concert when they have a relationship with each other such that one person influences or controls the actions of another through common ownership; and

(b) When persons are not commonly owned or controlled, they shall be treated as acting in concert only when the unity with which the purchasers have negotiated and will consummate the transfer of ownership interests supports a finding that they are acting as a single entity. If the acquisitions are completely independent, with each purchaser buying without regard to the identity of the other purchasers, then the acquisitions shall be considered separate acquisitions.

(3) The term "sale" shall not include (emphasis added):

(a) A transfer by gift, devise, or inheritance.

(b) A transfer of any leasehold interest other than of the type mentioned above.

(c) A cancellation or forfeiture of a vendee's interest in a contract for the sale of real property, whether or not such contract contains a forfeiture clause, or deed in lieu of foreclosure of a mortgage.

(d) The partition of property by tenants in common by agreement or as the result of a court decree.

(e) The assignment of property or interest in property from one spouse to the other in accordance with the terms of a decree of divorce or in fulfillment of a property settlement agreement.

Example Research Project

(f) The assignment or other transfer of a vendor's interest in a contract for the sale of real property, even though accompanied by a conveyance of the vendor's interest in the real property involved.

(g) Transfers by appropriation or decree in condemnation proceedings brought by the United States, the state or any political subdivision thereof, or a municipal corporation.

(h) A mortgage or other transfer of an interest in real property merely to secure a debt, or the assignment thereof.

(i) Any transfer or conveyance made pursuant to a deed of trust or an order of sale by the court in any mortgage, deed of trust, or lien foreclosure proceeding or upon execution of a judgment, or deed in lieu of foreclosure to satisfy a mortgage or deed of trust.

(j) A conveyance to the federal housing administration or veterans administration by an authorized mortgagee made pursuant to a contract of insurance or guaranty with the federal housing administration or veterans administration.

(k) A transfer in compliance with the terms of any lease or contract upon which the tax as imposed by this chapter has been paid or where the lease or contract was entered into prior to the date this tax was first imposed.

(l) The sale of any grave or lot in an established cemetery.

(m) A sale by the United States, this state or any political subdivision thereof, or a municipal corporation of this state.

(n) A sale to a regional transit authority or public corporation under RCW [81.112.320](#) under a sale/leaseback agreement under RCW [81.112.300](#).

(o) A transfer of real property, however effected, if it consists of a mere change in identity or form of ownership of an entity where there is no change in the beneficial ownership. These include transfers to a corporation or partnership which is wholly owned by the transferor and/or the transferor's spouse or children: PROVIDED, That if thereafter such transferee corporation or partnership voluntarily transfers such real property, or such transferor, spouse, or children voluntarily transfer stock in the transferee corporation or interest in the transferee partnership capital, as the case may be, to other than (1) the transferor and/or the transferor's spouse or children, (2) a trust having the transferor and/or the transferor's spouse or children as the only beneficiaries at the time of the transfer to the trust, or (3) a corporation or partnership wholly owned by the original transferor and/or the transferor's spouse or children, within three years of the original transfer to which this exemption applies, and the tax on the subsequent transfer has not been paid within sixty days of becoming due, excise taxes shall become due and payable on the original transfer as otherwise provided by law.

(p)(i) A transfer that for federal income tax purposes does not involve the recognition of gain or loss for entity formation, liquidation or dissolution, and reorganization, including but not limited to nonrecognition of gain or loss because of application of section 332, 337, 351, 368(a)(1), 721, or 731 of the Internal Revenue Code of 1986, as amended.

(ii) However, the transfer described in (p)(i) of this subsection cannot be preceded or followed within a twelve-month period by another transfer or series of transfers, that, when combined with the otherwise exempt transfer or transfers described in (p)(i) of this subsection, results in the transfer of a controlling interest in the entity for valuable consideration, and in which one or more persons previously holding a controlling interest in the entity receive cash or property in exchange for any interest the person or persons acting in concert hold in the entity. This subsection (3)(p)(ii) does not apply to that part of the transfer involving property received that is the real property interest that the person or persons originally contributed to the entity or when one or more persons who did not contribute real property or belong to the entity at a time when real property was purchased receive cash or personal property in exchange for that person or persons' interest in the entity. The real estate excise tax under this subsection (3)(p)(ii) is imposed upon the person or persons who previously held a controlling interest in the entity.